June/2019

"Mandatory requirements for the disclosure of true beneficiaries in the Baltic States – terms, procedures, problems"

1. REGULATION OF THE TRUE BENEFICIARIES

As technology develops and payment market is becoming more modern, more and more technology-based fintech companies are being established. Not only the market is expanding, but the legal requirements related to prevention of money laundering and terrorist financing are also growing. As a result, companies and their management face problems and high requirements implementing legislation.

The European Parliament and The Council of the European Union have adopted the Directive (EU) **2015/849** (hereinafter – **Directive IV** or **Anti-Money Laundering Directive**). This European Union law act obliges Member States to establish **Beneficial Owners** (hereinafter - **BO**) determination procedure. This directive has established requirements for identification processes of customers and beneficial owners, also it has appointed clients risk evaluation and application of prevention measures.

On 30th of May, 2018 The European Parliament and The Council of the European Union have adopted the directive (EU) **2018/843** amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (hereinafter – **Directive V**). This, fifth directive, dedicated to combat money laundering and terrorist financing, has established additional requirements for liable entities and mandatory requirements for virtual currencies conversion service providers.

In this LEADELL newsletter we will provide an overview of the implementation of the European directives regulating BO reporting in each Baltic State: Lithuania, Latvia and Estonia, followed by joint analysis.

2. GENERAL REGULATION

According to the Anti-Money Laundering Directive, the BO means any natural person who directly or indirectly controls more than 25 % votes of the company. If, after having exhausted all possible means and provided there are no grounds for suspicion, no person can be identified as BO or if there is any doubt that the person identified is actually the BO, then the natural person who holds the position of senior managing officials shall be held as the BO. Notwithstanding this joint regulation differences occur between Member States in specifying which head of which legal entity should be identified as the BO.

The legal entities of the Baltic States shall submit the following information on BO-s when implementing the Anti-Money Laundering Directive: a) name and surname; b) personal code; c) date of birth and the State which issued the personal ID card[1]; e) nature of the beneficial interest held.

3. IMPLEMENTATION IN LITHUANIA

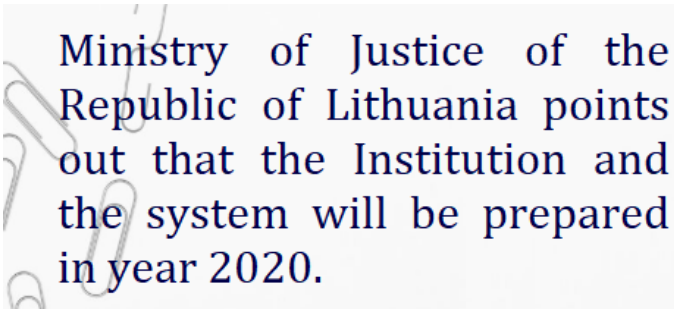
From January 1st, 2019, amendments that implemented the provisions of the Anti-Money Laundering Directive to the Law of the Republic of Lithuania on Money Laundering and Terrorist Financing prevention came into force. While analyzing Lithuanian anti-money laundering law, it is obvious that Lithuania has chosen the strict way of implementing the Anti-Money Laundering Directive.

[1] *According to the regulation in Latvia, date of birth and the State which issued the personal ID card is required only for persons who has no personal code.*

3.1 REQUIRED DATA AND TERMS

After the recents amendments of the Anti-Money Laundering Law came in to force on the 1st of January, 2019, it is mandatory for legal entities to store the information about BO. In Lithuania legal entities are bound to submit the information about BO to Lithuanian Center of Registers Information System of Legal Entities Participants (hereinafter - **Institution**). These data must be submitted within 10 days of the change.

It is necessary to note that, as for today, the system and administrative procedures for providing the aforementioned data to the Institution are not properly documented. Legal entities must store the aforementioned data related to BO, and when a national data system will be developed, companies will have to submit it to the processor.



As mentioned above, Lithuania has chosen the strict way to implement the Anti-Money Laundering Directive.[2] As for today, we can observe strict implementation, because legal entities, according to the projects of the legal regulations waiting to come into force, will have to provide not only required data about BO, but also information about all legal entities that are between the final shareholder, a natural person, and a Lithuanian legal entity. It means that Companies will need to provide data on the entire governance structure until the final BO, or ultimate beneficial owner (UBO), for the Center of Registers.

It is not the only obligation. Companies will have to justify the provided information. If governance structure of the legal entity goes beyond Lithuanian borders, it means that company will have to obtain extracts from foreign state registers and these extracts will have to be legalized. Also, extracts of companies that are controlled by UBO will have to be translated to Lithuanian language. Companies can also face the problem and be sanctioned for not knowing who are the BO or UBO of their parent company.

Required data to the processor will have to be provided by almost all companies. An exception is provided only for companies whose sole shareholder is the State or municipality and for those companies whose shares are traded on regulated markets.

3.2. SANCTIONS

Penalties for failure to provide data on final beneficiaries are set out in the Code of Administrative Offenses, but also there are other laws that determine sanctions for related offenses. Direct sanctions:

- For non-compliance with the established requirements a head of the company can be fined from 2 000 euros to 3 500 euros and for repeated breach fine may reach from 3 500 euros to 5 800 euros. Legal entity, for non-compliance with the established requirements, may be fined to 1 800 euros and for repeated breach fine may reach from 1 500 euros to 5 200 euros;
- If supervisory authority determines that submitted data is incorrect or legal entity fails to provide data about BO, sanctions for head of the company may reach to 1 450 euros.

Furthermore, there can be other indirect sanctions. If head of legal entity receives fine higher than 1 500 euros, under Lithuanian law, company is included in the list of unreliable taxpayers for one year, which can cause other inconveniences. For example, company can be excluded from the public procurement procedure. Moreover, notaries may refuse to act with a person who has not provided data on the BO.

The main supervisory authorities under the Lithuanian law are the Financial Crime Investigation Service and the Bank of Lithuania. If failure to provide data about BO would be linked to money laundering and terrorist financing, then the responsibility would be much stricter. Law on the Prevention of Money Laundering and Terrorist Financing of the Republic of Lithuania establishes extremely strict sanctions for companies and their heads. For example, a financial institution may be fined for violations of that law from 0,5 % to 5 % of total annual income. And for serious or repeated breaches financial institution could receive fine from up to 10% of total annual income or from 2 000 euros to 5 100

[2] *It must be pointed out that Latvia has chosen a very similar way of implementing the Anti-Money Laundering Directive.*

000 euros. Head of financial institution or its participant could receive sanctions for systematic irregularities or gross violations from 2 000 euros to 5 100 000 euros.

Moreover, if non-submission of data about BO or UBO is linked to money laundering or terrorist financing it may lead to criminal liability. Criminal Code of the Republic of Lithuania provides a penalty of up to 10 years of imprisonment for both, legal entities and natural persons. Criminal liability also arises for property acquired through criminal activities and sanctions can reach up to 4 years of imprisonment.

4. IMPLEMENTATION IN LATVIA

On 9 November 2017, amendments to the Law on the Prevention of Money Laundering and Terrorism Financing, hereinafter LatAMLlaw, entered into force, which stipulated that, as from 1 December 2017, all legal persons registered in the Enterprise Register, subject to the exceptions laid down by law, must submit information regarding the BO-s.

On 13 June 2019, extensive amendments to the LatAMLLaw have been adopted, which substantially increases the powers of the Enterprise Register and extends the circle of persons to be provided with information on the BO-s.

4.1. REQUIRED DATA AND TERMS

According to the Latvian law the legal person shall collect and store the aforementioned information on its BO. Besides there is also requirement to submit country of residence, citizenship and way of exercising control over the legal person, including the name, surname, personal code of the shareholder, member or owner through which the control is exercised. For persons with no personal code the date, month and year of birth, document number and date of issue, country and authority which issued the document is also required. Legal entities will have to provide not only required data about BO, but also information about all other legal entities that are between the final shareholder, a natural person, and a Latvian legal entity.

A legal person registered in Latvia shall be able to submit the information listed above regarding the BO to the Enterprise Register without delay, but not later than within 14 days from getting to know the relevant information.

The Saeima (Latvian Parliament) has recently passed the amendments which, however, grant the Enterprise Register the right to request a documentary justification for the control carried out, as well as documents confirming information on the identity of the BO. The Enterprise Register will therefore be able to assess more effectively the veracity and relevance of the information submitted, as well as to assess the risks to the BO-s of the legal entities.

According to the above-mentioned amendments to the law, information on BO-s must also be provided to the representative offices, permanent representations and branches of foreign companies. If the legal person has concluded that it is not possible to determine any BO, it must be indicated in the application, stating the reasons.

4.2. SANCTIONS

If no information is provided to the Enterprise Register regarding the BO, a warning may be received or a fine of between 70 and 700 euros may be imposed. In addition, Criminal Law also lays down criminal liability for the provision of false information to a State institution for which temporary deprivation of liberty, forced labour or financial penalty may be applied.

A person who does not provide or deliberately provides false information to a natural or legal person who is not a State institution and who is authorised by law to request information regarding the BO shall be punishable by deprivation of liberty for a period of up to one year or temporary deprivation of liberty, or a forced labour, or a fine.

According to the recently passed amendments to the Criminal Law, greater responsibility for failing to provide information or for knowingly making false statements, including imprisonment for up to two years, has been established. These amendments will be applicable both in cases where information is not or is submitted misleading into State institutions or other Legal persons who are authorised by law to request information regarding the BO.

If the company has not submitted the information or documents required by the Enterprise Register, it must be taken into account that the activities of the company shall be terminated.

In the case of commercial companies, the responsibility of the board may also arise for the failure to comply with these Regulations. Sanctions against the board may be enforced if the company suffers losses, and if the board is unable to prove that he has acted as a good and careful master.

5. IMPLEMENTATION IN ESTONIA

On 26 October 2017 the Estonian Parliament adopted the „new" Money Laundering and Terrorist Financing Prevention Act (hereinafter – **EstAMLAct**). According to the explanatory note of the act, the reason for adopting the new law was the need to implement Directive IV, as well as principles of the then draft Directive V. EstAMLAct took effect on 27th November 2017, whereas relevant provisions related to reporting on BO took effect as of 1 September 2018.

5.1. REQUIRED DATA AND TERMS

According to EstAMLAct, the general concept of BO-s and required information about BO-s is similar to the above-mentioned information on how it is laid down in the Anti-Money Laundering Directive.

The EstAMLAct requires that a legal person would gather and retain data on its BO, including information on its right of ownership or manners of exercising control. The data of the BO is kept in the Commercial Register by the management board of the private legal person.

The duty to submit data on BO does not apply to apartment ownerships, building associations, companies and certain limited foundations.

Where the submitted data changes, the company, non-profit association or foundation shall submit new data via the commercial register information system not later than within 30 days after learning of the changes in the data.

5.2. SANCTIONS

According to EstAMLAct the penalty for failure by a shareholder or member of a private legal person to submit the data of the beneficial owner or for failure to report on a change of the data or for knowingly submitting false data leading failure to apply required due diligence measures for specifying the BO, is a fine of up to EUR 1200. The penalty for the same act committed by a legal person is a fine of up to EUR 32 000.

The failure to submit required data regarding BO does not amount to a crime in Estonia. However, Estonia has also implemented the so-called Directive VI (Directive (EU) 2018/1673 of the European Parliament and of the Council of 23 October 2018 on combating money laundering by criminal law).

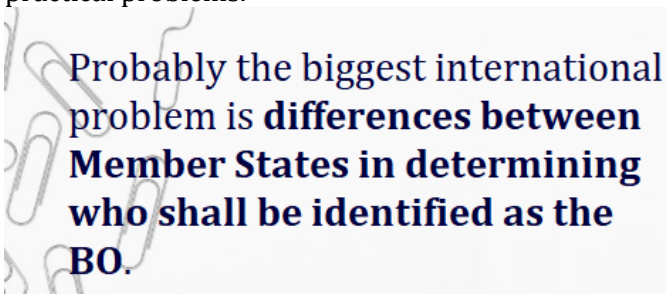
6. ADVANTAGES AND POTENTIAL PROBLEMS

With regard to the implementation of the discussed regulation combating money laundering and terrorist financing we can see both positive things, as well as certain problematic aspects.

From one side, with the correct database, registers would have a potential of being a powerful tool to the money laundering prevention. With reliable data, it can be used as a basis for customer knowledge. In addition, the relationship between legal entities and financial institutions could be facilitated because banks and other financial institutions will have access to the data about BO provided in the public registers, so in some cases the legal entities might not need to provide this data one more time (in some cases the banks certainly request for updated and specified information). Further, it could be argued that the reporting obligation has somewhat simplified the fulfilment of obligations by different market players. For example, according to the EstAMLAct, the obliged entities (i.e. different players on the market) must apply also the following due diligence measures: identification of the beneficial owner and, for the purpose of verifying their identity, taking measures to the extent that allows

the obliged entity to make certain that it knows who the beneficial owner is, and understands the ownership and control structure of the customer or of the person participating in an occasional transaction. If the management board has fulfilled its obligation to identify the BO and registered this with the Commercial register, this simplifies the fulfilment of the due diligence obligation by the others.

From the other side, the regulation is not without practical problems.



As mentioned above, according to the Anti-Money Laundering Directive, the BO means any natural person who directly or indirectly controls more than 25 % votes of the company. If, after having exhausted all possible means and provided there are no grounds for suspicion, no person can be identified as BO or if there is any doubt that the person identified is the actual BO, then the natural person who hold the position of senior managing officials shall be held as the BO. It is important to note that differences occur between Member States in specifying which head of legal entity should be identified as the BO. It means that in one Member State, it is necessary to indicate the head of the legal entity itself (e.g. management board member of the reporting entity) (**Estonia, Latvia**) and, in other countries (**Lithuania**), the head of the shareholder should be registered as the BO. This can cause inconvenience identifying the parent company's BO.

Also other problem in this case, if the scheduled adjustment in **Lithuania** does not change, is that Lithuanian legal entities will have to provide data to processor not just about the ultimate beneficial owner (UBO) as a natural person, but about the whole structure of the chain of legal entities. If a group of legal entities crosses Lithuania or if the structure of a legal entity is complicated then there may be problems in setting the BO (or UBO) and in submitting the documents to the processor.

Furthermore in **Estonia** the currently prevailing interpretation of the law is even more absurd in case of a company owned by the state or a city. According to the guidelines issued by the Ministry of Finance, in such a case the respective minister or the mere shall be registered as the BO. The guidelines do not allow the registration of the state or the city. Yet it is, of course, clear that the minister or the mere is not the person who actually benefits from the state/city-owned company. Thus the current regulation is pointless.

Difficulties can also occur in other situations, for example, according to Estonian law, the natural person who holds the position of a senior managing official is deemed as a BO. According to the guidelines, this means that the members of the board of the controlling company shall be registered as BO-s. This raises practical problems. First, considering that the local board members may not be aware of changes of management on higher structures, such reported data may be incorrect. Further, *inter alia*, the Estonian legal chancellor has argued that such conclusion places disproportionate administrative burden on the local company (especially considering that management structures may considerably differ in Member States). In our view, this administrative burden would be justified if the actual BO would be specified as a result (as is the general rule). However, it is clear that the board members of the (grand) parent company are not the actual BO-s. In view of this, it does not make sense to place such investigative burden on local board members. Instead, it would make more sense to register local board members as BO-s in case the actual controlling natural person cannot be identified. To our knowledge this latter interpretation has been adopted in most other EU countries. An even better solution would be to state that BO-s cannot be identified, then the names would not cause any confusion.

7. SUMMARY

As we can see there are a lot of discrepancies and differences in the international Anti-Money Laundering regulation and non-compliance of the requirements can cause very strict sanctions, therefore it is worth taking proper care of submitting all the necessary data related to beneficial owners to the authorized authorities, as well as carrying out a deep advance analysis of the data to be submitted.